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SUBJECT: KAZAKHSTAN DIPS ITS TOE IN ETHANOL

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1. (SBU) Summary. The recently built ethanol plant in North Kazakhstan Oblast is touted by regional officials and company executives as the first ethanol production facility in all of the CIS. Officially opened in September 2006 (with President Nazarbayev pressing the "start" button to great fanfare), the plant is now planning to make its first export shipment, most likely to Finland. The facility's owner, the Almaty-based BIOHIM, is already eyeing constructing more ethanol plants in Kazakhstan and considering production of biodiesel as well. The company, the recipient of \$60 million in state financing, enjoys government support and is looking forward to the expected passage of legislation it helped write that will introduce in Kazakhstan a minimum ethanol use requirement. End Summary.

The Business Model

2. (SBU) Kazakhstan's first bioethanol plant is located in Tayynsha (pop. 13,000), the official center of the overwhelmingly agricultural Tayynsha Rayon of the North Kazakhstan Oblast. Anatoliy Makovskiy, the rayon's akim for ten years (since the rayon's establishment following a redrawing of official maps), told visiting Econoff that Tayynsha's biggest draws for BIOHIM were abundance of high-quality wheat, the proximity of a major railroad line, and "cheap" water. Makovskiy spoke of the BIOHIM plant being at the center of a "production chain:" the locally grown wheat is converted into ethanol and useful byproducts, with some of the latter being used as feedstock for locally raised cattle. "Basco," a Kazakhstani company with a stake in BIOHIM, is currently building in Tayynsha a cattle farm and a meat processing plant. The akim proudly declared to Econoff that his rayon is facing labor shortages even among unskilled workers.

3. (SBU) According to Yermek Berdinov, the BIOHIM plant's director, sales of byproducts are a critical aspect of the operation, which cannot be profitable solely by selling ethanol. Berdinov estimated that for each dollar of revenue, 70 cents would derive from ethanol and 30 cents from the useful byproducts. These byproducts, he said, include gluten, starch, and carbon dioxide. The economic necessity to produce the byproducts, Berdinov explained, results in a highly complex production process. Thus, while BIOHIM imported all its technology from Europe, the plant's production system is uniquely designed to take advantage of the high quality of local wheat that enables extraction of the byproducts in addition to ethanol. Production, Berdinov noted, is highly automated; the facility, which operates around the clock, employs a relatively modest 300 or so people. During the mid-day tour, the buzzing plant appeared quite deserted.

4. (SBU) The company plans to export its ethanol production to Europe, most likely to Finland, by rail. Berdinov approximated that

transportation costs would constitute roughly 1/5 of ethanol's price in Europe. However, BIOHIM is now looking forward to selling its ethanol domestically as well. Berdinov expects adoption of a law (that he and another BIOHIM executive helped draft), which will introduce mandatory use of ethanol. The content requirement will start at 5% and come into force in 2008. Berdinov remarked that Kazakhstani gasoline is currently of very low quality, precluding the possibility of mixing it with ethanol. This, he noted, will change with the new law, which will introduce European quality standards.

15. (SBU) BIOHIM, Berdinov said, is eyeing expansion. A "strong interest" is biodiesel, but the company is also preparing plans for construction of another, larger ethanol plant. The "desired plant size" from the economic perspective, Berdinov explained, calls for a 150,000 ton capacity. The first plant, he said, provides 57,000 tons.

The Government Takes (Strong) Interest

16. (SBU) Financing for BIOHIM's first plant, Berdinov said, was provided by a number of financial institutions, including German, Finnish, Russian, and Chinese banks. What distinguishes the project, however, is the \$60 million loan the company received from the Development Bank of Kazakhstan (DBK, the largest institution of the government-owned "Kazyna" Sustainable Development Fund), the DBK's largest single loan to date. Berdinov acknowledged that the terms of the DBK loan were no better than those offered by commercial institutions. What the DBK's involvement provides, he said, is "the government support."

17. (SBU) In addition to branding the BIOHIM facility "a breakthrough project," a key political buzzword these days, the government is planning to launch its own ethanol production plants. These would be run by KazAgro, a recently created state holding company for the government's agricultural assets. With KazAgro's planned entry, the

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Kazakhstani ethanol industry appears to be headed for public-private competition. Berdinov predicted an "ethanol boom" in Kazakhstan.

18. (SBU) There is still more the government needs to do to make ethanol economically viable. Berdinov told Econoff that BIOHIM is currently stymied by a statutory failure to recognize ethanol as a form of fuel. According to press reports, BIOHIM is unable to export its ethanol because CIS countries uniformly classify all ethanol as a "food product," imposing on it an exorbitant excise tax, which results in a sixteen-fold increase in its cost. Alikhan Smailov, KazAgro chairman, is quoted by the press as stating that the solution lies in having a CIS commission task member states to change their tariff schedules accordingly. He expects this issue to be resolved soon.

Comment

19. (SBU) Comment. The BIOHIM ethanol plant, in some ways, epitomizes the government's stated ambition to diversify the economy away from the extractive sector and toward high value-added, high-tech, export-oriented industries. Moreover, through its linkages with the agricultural sector (by using wheat as input and marketing ethanol byproducts as feedstock), the plant significantly stimulates employment and provides a strong boost to an area, which - like much of rural Kazakhstan - had been mostly untouched by the country's economic boom. At the same time, BIOHIM's decision to rely on government financing in order to ensure political support, along with its success in contributing to the passage of favorable legislation, highlights the importance of political muscle in navigating Kazakhstan's investment waters. End Comment.

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